Memorandum

To: Frederick Davis, Director of Land Stewardship

From: Allen Vann, Inspector General
Tim Beirnes, Senior Auditor

Date: April 17, 1997

Re: Accounting System Survey of South Florida Aquaculture, Inc. - Audit Review #97-12

INTRODUCTION

As requested, we visited the AeroJet Fish Farm (the "Fish Farm") on April 1, 1997, and met with the Vice President of Fish Production and Treasurer of South Florida Aquaculture, Inc. (the "Company"). The purpose of the meeting was to perform an accounting system survey and review the internal controls over their sales, production, and inventory, to ensure that production payments to the District under Contract C-7335 are fairly stated. Following is a summary of our limited review and resulting conclusions.

BACKGROUND

In 1993, the District purchased some property adjoining the Everglades National Park in southern Dade County, located southwest of Homestead. The property was formerly owned by AeroJet, hence resulting in the name AeroJet Fish Farm. In February 1996, the District leased the property to The Company for a period of 20 years. Lease terms provide for annual rental

payments of $2,224 paid in advance commencing April 1, 1996. In addition, the lease terms require the tenant to
pay production payments based on the amount of fish sold. These terms are as follows:

Hybrid Striped Bass	0 to 6,000 boxes - $0.75 per box Over 6001 boxes - $0.50 per box
Bait Fish (total pounds sold)	$0.0175 per pound up to 300,000 lbs. $0.0150 per pound over 300,000 lbs.
Other Fish (total pounds sold)	$0.0175 per pound up to 300,000 lbs. $0.0150 per pound over 300,000 lbs.

Progress payments are required on the 10th day following the end of each calendar quarter. Production quantity thresholds are based on annual production based on the calendar year.

The Fish Farm contains three groups of raceways, however, only one phase containing 20 raceways is currently in use. The other two phases collectively contain 65 additional raceways for a total of 85. The Company intends to place additional raceways into production after the current phase reaches capacity.

FIELD VISIT OBSERVATION

Accounting System Survey

Accounting records are maintained, by the Vice President of Fish Production, at the Fish Farm location using a personal computer and “Quickbooks” accounting software. The accounting software is used to generate sales invoices, cash receipts, cash disbursements, etc. Fish inventory, however, is maintained on “Excel” spreadsheet software. The records are maintained on both diskette and in hard copy format. The Company’s fiscal year is the calendar year. The Treasurer requires the Vice President of Fish Production

to provide him with weekly reports. The Company's accounting firm is Templeton & Associates, located in West Palm Beach, Florida.

Sales

The optimum marketable fish size is two pounds. The Company anticipates production to range between 5,000 and 6,000 pounds per week, resulting in an annual production of 250,000 to 300,000 pounds per year from the 20 raceways currently in operation. Production will increase in the future if additional raceways are placed into production. Hybrid Striped Bass is the only specie currently in production.

Fish sales commenced during March 1997 and are generally sold by the pound in 50 pound box units. Fifty pounds of fish are packed into an industry standard, insulated, waxed, cardboard box with a scoop of ice thrown on top. Some fish are also sold live from the tank. These sales are called a live haul. In these situations, the weight is converted to box equivalents at the rate of 50 pounds per box. Sales are recorded by generating continuous invoices for each sale. A monthly summary of these invoices is then prepared for reporting purposes. Controls appear to be adequate for a company of this size.

Inventory

The inventory process commences with delivery of sterile fish fingerlings. The fingerlings are about ¾ inch long and are currently purchased from a fish hatchery in Arkansas. The first fingerlings were delivered to the farm on May 31, 1996. Fingerling deliveries from the hatchery are accompanied with a load sheet showing the number and weight of each compartment on the truck. This load sheet is then compared to the invoice.

We observed that fish of similar size are grouped together in raceways to minimize their mortality rate. As the fish mature, they are transferred to other raceways until they reach market size and are

harvested. It takes about one year for these fish to reach the optimum market size of two pounds.

Inventory records are maintained on an Excel spreadsheet for each of the 20 raceways. This spreadsheet begins with the number of fingerlings purchased, then subtracts mortality losses and sales, and then adds or subtracts transfers between raceways, to arrive at the ending inventory balances. According to the Company's Treasurer, mortality is almost impossible to track during the fingerlings first six weeks in the tanks. Mortality counts, transfers, and number of fish harvested, are recorded on a "Daily Inventory Sheet" by a field employee. Daily Inventory Sheets are completed for each raceway and contain a line for each day of the month. The sheets are summarized at the end of each month and the totals posted to the inventory spreadsheet. Inventory quantities are converted to weight by weighing a sample of fish in each raceway and then applying this average weight to the quantity in each raceway. The Daily Inventory Sheet does not require any employee signatures.

Data in the sales column on the Excel inventory spreadsheet is based on the number of fish removed from the tank to fill orders. These fish are removed from the tank as needed to fill orders as they are received. Thus, there is usually no inventory maintained outside of the tanks other than what is necessary to fill the current day's orders. Currently, sales invoices are not reconciled to the fish sold per the inventory spreadsheet. This creates a disconnect in the flow of transactions. There is no physical inventory taken, due to lack of an effective method by which to count fish, and is an inherent control weakness in the fish production industry.

Farm Tour

We toured the Fish Farm and observed the 20 raceways in operation. We also observed the building and coolers where the fish are packed and stored for shipping. We also observed the standard 50-pound carton used for packing and shipping. The carton is an average size box made of waxed

cardboard with styrofoam insulation. We did not observe the other two non-producing phases of the farm.

Estimated Revenues

Based on our review of records, tour of the farm, and invoices for fingerling purchases, projected annual production in the 300,000 pound range appears reasonable. At this level of production, the District would realize production payments of $4,500. Adding this to the base lease payment of $2,224 will yield about $6,700 annually to the District. If the other 65 raceways are developed and provide similar production results, the maximum annual revenue the District can anticipate from the lease is about $20,000. There is no provision for an annual CPI adjustment in the lease.

In addition to the lease payments, the tenant is required to control exotic vegetation on the property. Thus, the District will receive additional compensation through the value of such in-kind services.

CONCLUSION

Identified Control Weaknesses

The following internal control weaknesses were identified based on our observations and discussions with the Company's officers.

1. The sales are reported based on a summary of invoices generated from actual sales. Sales per the inventory spreadsheet are based on the number of fish removed from the tanks. The two numbers are not currently reconciled, thus creating a disconnect in the flow of transactions.

2. The inventory spreadsheet is not formatted to confirm that transfers between raceways net out to zero.

3. The sheets used to record the mortalities do not require any signature or initial of the employee documenting the information.

4. Physical inventory has never been taken due to the lack of a practical and effective method to perform one. This creates an inherent weakness.

5. Due to the small size of the company, typical internal control mechanisms, such as segregation of duties, are not feasible.

The above internal controls were verbally communicated to the Company's officers during our field visit. They concurred that items 1,2, and 3 were good ideas and would seriously consider implementing them. On item #4 regarding physical inventory, we suggested they contact other businesses in the industry (particularly publicly traded ones), and inquire how they address this dilemma. The Treasurer said he knew of one such company in Canada and would contract them. Item #5 is addressed by the Treasurer requiring frequent (i.e. weekly) reports from the Vice President of Fish Production.

Follow-up

Sample copies of documents were received from the Company on April 7, 1997. These documents included a revised sales reporting form that sufficiently reports sales in accordance with contract terms. Also submitted was a revised version of the Daily Inventory Sheet, which provides a space for signature and date.

Overall Assessment

Overall, the Company appears to have an accounting system and audit trail to provide sufficient supporting documentation for fish sales, subject to the inherent limitation of lacking a practical method to economically perform an effective physical inventory. Based on the follow-up information received

from the Company, they have already addressed some of the suggestions made during our meeting. Since the Company purchases all sterile fingerlings, it is also possible to form reasonable expectations of annual production, and thereby develop a reasonable estimate of what production payments should be. Also, based on the amount the District receives per box/pound, the effect of an understatement in sales quantity would not translate into a material dollar amount. For example, if actual Hybrid Striped Bass sales were 6,000 boxes but reported sales were 5,400 boxes (20% less), the resulting revenue discrepancy is $900. The primary compensation under the contract may actually be the value of the in-kind services. Therefore, contract provisions regarding exotic vegetation control should be monitored for compliance.

If you have any questions or concerns, please call Mr. Tim Beirnes at ext. 6398.

c: Samuel E. Poole, III
Michael Slayton
William Malone
J.B. Jackson